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This paper discusses the need to reduce the costs of the current DOD retirement program through reform that reduces payout obligations for entering service members, modifies the cost of living adjustment (COLA) of retired members, and implements structural changes to eliminate the sense of entitlement that promotes the existence of the current structure.

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PREFACE AND ACKNOWLEDGEMENTS

I chose the topic of retirement reform because of a growing mentality of owed entitlements in today's workforce. I believe a mentality of "what you can do for me" is hurting our nation and the future of our nation. This mentality exists in the military community and is most evident among those that argue to maintain the current retirement program. The current program has become a detriment to the future capabilities of the American military and the entitlement mentality has helped to prevent reform correcting the issue of excessive cost. As a result, I believe the military retirement program requires reform that not only reduces cost but also eliminates the entitlement mentality many have come to expect.

With every command that I have reported to, I have tried to find specific aspects that need improvement. I have entered each command with a personal belief that I have a responsibility to better every part of that command to which I am exposed. In most cases, I have found that allowing programs within a command to continue would have little to no negative effect to the command in the short term. On the other hand, failure to act with the future in mind would have significant long-term effects. The argument for immediate reform is a fundamental issue with the current Department of Defense (DOD) retirement program and is the basis of my argument. Changes made now, if done correctly, will have a positive effect on the future of our force capability, limit force structure impact and change the mentality of entitlements. Failure to reform the program now will require drastic and unfair changes in the future. The current program cannot continue to exist or it will be a detriment to military capabilities, a limited defense budget, growing national deficit, and the American taxpayer.

I would like to thank my friend and colleague LCDR Doug Martin, USNR for recommending this topic and for providing feedback on this paper. I would like to thank Dr.

Francis H. Marlo, my thesis mentor, for keeping me focused on one specific argument and for his patience with seeing this thesis to its conclusion. Finally, I would like to thank my wife, Anna, for her patience and support during my year at Command and Staff College and her help with editing and constructive feedback on my thesis.

EXECUTIVE SUMMARY

Title: The Need for Reforming the Department of Defense Retirement Program

Thesis: This paper will argue the need to reduce the costs of the current DOD retirement program through reform that reduces payout obligations for entering service members, modifies the cost of living adjustment (COLA) of retired members, and implements structural changes to eliminate the sense of entitlement that promotes the existence of the current structure.

Discussion: Because of the broad possibilities of topics to argue with respect to military retirement, this paper will focus specifically on the DOD retirement program as it pertains to active duty personnel without disabilities. The current program is more generous than it needs to be for today's service member and significantly more costly than it can be for the discretionary budget of 2025 and beyond. This excess is at the cost to the taxpayer and detriment to the defense budget directly affecting a range of systems from the national debt to the future capabilities of our military services. Statistics alone show that the cost of the current program is unsustainable. In order to change the program in such a way that is fair to current and retired service members it must grandfather the basic annuity. Furthermore, failure to act now will only delay required reform. Delay to reform even by a few years will cause unfair and drastic measures in order to prevent its impact on the economics of the United States and the future capabilities of the U.S. Military. It is the significant impact to the military's primary mission that necessitates the immediate reform of the program.

Conclusion: The current U.S. national debt has reached \$14 trillion and as such, reduction in spending is a primary goal of the current government's administration. This reduction directly affects discretionary spending and the budget of the DOD. With more than \$178 million in cuts proposed for the FY2012 budget, the affects of limited spending are showing their impacts on the current and future capabilities of the United States military. Deficit reduction will not occur in one to two years. Pressure to maintain a limited defense budget will continue to affect the current and future capabilities of the United States Military if it must pay excess costs for inefficiencies and entitlements.

The continuing rise in cost of the current retirement program has already reached unaffordable amounts and will continue to increase. Historical analysis shows that fewer and fewer service members are dying in each major engagement and living longer lives after retirement. As a result, the amount of money required to pay retired service members has significantly increased the budgetary requirements.

The current structure of the military retirement program is more than sixty years old and needs to be reformed. This structure, based on a twenty-year vestment with an immediate annuity is a cause for the current entitlement culture and reform from a defined benefit plan to a defined contribution plan is necessary to instill a sense of responsibility in one's own retirement income and reduce the cost to the federal government.

The current retirement program is in need of reform to reduce cost. Reform needs to adjust structure to affect the culture of entitlement. Failure to meet these objectives will result in an unsustainable program that adversely affects the primary responsibilities of the U.S. Military.

INTRODUCTION

In general, pension systems in America have evolved from a payment-because-of-disabilities program for those who served in the Revolutionary and Civil Wars to a delayed benefit or entitlement to former employees both civil and governmental.¹ In 1935, President Franklin D. Roosevelt and his administration developed the New Deal in response to the Great Depression. One part of the New Deal was legislation establishing the Social Security program. Under the program, workers were taxed a portion of their pay to later guarantee a modest income from the government after retiring. This income was meant to be a supplement of income to personal savings in order to ensure people would have money for essentials after they were too old to continue working.

The design of the current Department of Defense (DOD) retirement program is much the same in that it provides a modest level of supplemental income to personal savings once retired from military employment. However, the DOD uses the entitlement of a retirement annuity as more than just a supplemental income once a service member has served twenty or more years. This stems from the DOD having two main categories of economic benefits that it provides to its members. They are current benefits such as salary, bonuses, medical, housing and subsidies, and delayed benefits such as a pension, medical, and subsidies. The DOD treats retirement not merely as a supplemental income to savings, but as a delayed economic benefit. As a result, the retirement program also acts as a catalyst for retention of mid-career service members. This directly affects force strength because as most people become accustomed to a way of life based on their income, they realize the positives and negatives that usually affect quality of life when beginning a new career and the current military pension program offers an incentive to remain in the military. This tool for retention helps to maintain enough quality service members for

promotion to senior positions in the military. Retention of quality service members is an important aspect for the military to maintain an elite power-projecting force capable of deployment around the world.

However, over the past fifty years, the cost of maintaining the military retirement program has risen to points that have caused Congress and the DOD to assess the program's structure due to its effect on the DOD and federal budgets, taking into consideration fairness of benefit and effects on force structure. To correct the cost impacts, a couple of important changes have taken place over the last thirty years that have helped to reduce the cost without significantly affecting retention. However, because of actual and perceived force management impacts, the DOD and Congress have limited the amount of cost reduction and even repealed some of the cost saving changes.

Right now, the national deficit is the highest it has ever been at more than \$14 trillion² and the annual cost of the U.S. military is the highest it has ever been at \$663.8 billion.³ The defense budget as a percentage of GDP is the highest it has been in nearly two decades at 4.8% and has consumed annually between 48% and 73% of discretionary spending since 1962.⁴ The national debt is at the forefront of political debates and one of the leading national security issues facing the current administration.⁵ The federal government can no longer continue to spend money it does not have, and political pressure is building for significant cuts in discretionary spending. Since the defense budget makes up the largest portion of discretionary spending (Figure 1), it too will require cuts. Reform of the retirement program is a way the DOD can reduce cost in the near and long-term without affecting its primary abilities to defend the nation and its interests.

The current retirement program structure is a defined benefit plan (DBP) with an immediate annuity after completing twenty years of service. This vestment after twenty years of service (YOS), also known as the twenty-year paradigm is more than sixty years old and the means to determine the annuity for 85% of the retiring service members is thirty years old. These two measures together have produced a program that is inefficient and out of date with current economic practices. There is an immediate need to reduce outlays in all areas of the military pension program to correct these issues. Doing so will positively affect the national deficit, the federal and DOD budgets and prevent a negative effect to the military capabilities of the future. This paper will argue the need to reduce the costs of the current DOD retirement program through reform that reduces payout obligations for entering service members, modifies the cost of living adjustment (COLA) of retired members, and implements structural changes to eliminate the sense of entitlement that promotes the existence of the current structure. Such reform will ensure adequate funds for the capabilities of the U.S. military.

This paper is comprised of six sections. Section One discusses relevant aspects of the federal deficit and its relationship to the DOD budget. Section Two discusses significant changes to the retirement program over the last fifty years and the current pension program structure. Section Three discusses the effects to force structure from reform. Section Four discusses the argument for reform. Section Five discusses possible solutions to the current program. Section Six provides conclusions and recommendations.

SECTION 1: BACKGROUND

In order to understand the requirement for military retirement reform, one must first understand that there are two primary factors driving the requirement. The first is the cost of the system and its impact on the military's primary responsibility to maintain a force able to defend a nation and its interests at home and abroad. Cost has become an issue because of the fiscal constraints being placed on the DOD budget due to a high national debt. The second deals with the relevance of a retirement structure designed more than 100 years ago that has had little significant change to represent the expectations and requirements of America's 21st century military force and the national economic expectation. This section will provide information on these two factors before arguing them in the following sections.

A significant force affecting change to the current retirement system is the growing federal deficit and its impact on the defense budget. The federal budget is comprised of three forms of spending: interest spending, mandatory spending, and discretionary spending.⁶ By law, the federal government must pay interest spending and mandatory spending first.⁷ What remains of the budget pays for discretionary spending, which includes the DOD budget. The amount spent on discretionary items changes based on government tax revenue and how much the government is willing to risk from borrowing money. Since the seventies, the amount of funds made available to the DOD has gone up, but reductions have occurred in discretionary spending as a percentage of Gross Domestic Product (GDP) due to increased outlays for interest and mandatory spending. Tax cuts made by the Bush administration and extended by President Obama have further catalyzed the need for reduction in discretionary spending and borrowing. The federal government has been willing to borrow large sums of money in its history to cover the costs of those things it deemed necessary to ensure the American way of life. Whether or not

the funds were spent in the best interest of the nation is debatable, nevertheless the money has already been spent and now America finds itself with a gross debt of 84% of its GDP.⁸ This percentage may not seem high when compared to the gross national debt held by Japan, 198% of its GDP,⁹ but comparisons are not the correct way to rationalize a national security issue for America. The seriousness of this issue is realized by many, including the National Commission on Fiscal Responsibility, which warned of “an approaching debt tsunami that could destroy American prosperity if government spending isn’t slashed.”¹⁰

Discretionary spending makes up about 39% of the overall U.S. budget, compared to mandatory spending which is about 56% and interest spending which is 5%.¹¹ The Defense budget currently makes up a little over 50% of discretionary spending which has declined as a percentage of GDP since the Korean War.¹² (Figure 2) This decline is the result of the increase in America’s GDP over the past fifty years, an increase in mandatory spending on an aging population and an increase in interest spending due to the nation’s debt. Since mandatory and interest spending must be paid first, discretionary spending is where the difference between total revenue and outlays are absorbed. (Figure 3) Major David Joseforsky, a student at the Marine Corps Command and Staff College, argues that “the U.S. economic situation jeopardizes discretionary spending” and ties the national debt and its indirect effect on the defense budget to influencing America’s superpower status.¹³ He does this by explaining how the need to reduce the deficit comes from reducing spending without borrowing. Reducing the amount of money for discretionary spending will reduce the DOD budget, reduce the capabilities of the military, and diminish America’s superpower status. This compelling argument specifically ties the national debt to the DOD budget and its indirect effect on America’s ability to successfully operate, train and prepare for the conflicts of tomorrow. This paper goes further to argue why the DOD

pension program requires reform in order to prevent reductions in the DOD budget from affecting operational, training and procurement requirements.

The current program is actually more than 100 years old, which is the second factor making reform of the retirement program necessary. The Naval Service Appropriations Act of 1908 actually established the first vestment for voluntarily retirement from the military at thirty years.¹⁴ The same Act in 1916 established the up-or-out selective promotion plan and initiated the formula for determining retired pay (2.5% per year).¹⁵ The Act of 1946 is what changed the thirty-year vestment to a twenty-year vestment.¹⁶ All three of these changes were done to “provide a means to break up the officer logjam that had arisen out of the large number[s] of war accessions who could no longer be effectively employed.”¹⁷ As stated by the 1998 RAND report *Reforming the Military Retirement System*, the current system dates back to 1947, when Congress implemented a common retirement system for officers and enlisted personnel.¹⁸ The report continues to explain how changes made throughout the program’s history have not gone so far as to change the vestment paradigm, nor have the changes modified the program from its noncontributory roots first argued by the Hook Commission in 1948.¹⁹ The Commission made this recommendation because it claimed the military was backed by a government that had the power to tax and therefore did not have to worry about the retirement outlays of the future.²⁰

Only three significant changes have occurred since the program’s inception. These changes reduced cost, incentivized a longer career, or accomplished both. One change made in 1981 reduced the cost of the retirement program by changing the way DOD determined the annuity amount. The annuity or the final basic pay amount is determined by averaging the member’s basic pay for the last three years of his or her service rather than using the member’s final highest basic pay amount. This change also incentivized service members to work an

additional tour to ensure their average base pay was that of their current pay. Another modification to the program occurred in 1985, which changed the system from a pay-as-you-go system to an accrual-based system. This modification required the DOD to estimate future retirement costs based on the current force structure and pay that cost into a retirement fund, rather than pay for the cost of those already on retirement. This change reduced the retirement outlay for future DOD budgets by setting money aside into a fund that would grow absorbing inflation costs. Finally, in 1986, reform reduced the cost and promoted longer careers by reducing the annuity at twenty years of service from 50% of basic pay to 40%. To promote a thirty-year career, the percentage would increase incrementally to match that of the 75% basic pay annuity at thirty years of service. However, Congress repealed this change in 1999, allowing all service members affected by the reform to revert to the previous HI3/36 system or maintain the current system with an added \$30,000 bonus paid to the service member at the fifteen-year point in their career. This bonus incentivized staying with the current program, but few service members chose this option. Even today, the Defense Actuary reports that only 15% of retiring service members chose the CSB/REDUX program.²¹

These changes emphasize the meager attempts made to reduce the costs of an expensive program by changing the annuity or increasing the career length of a service member. Only one change since 1947, the implementation of an accrual system, brought the program a step away from its foundational roots. The current program, since its inception, remains a defined benefit plan. Today there are many issues requiring the efficient use of tax revenue and the inefficiency of the defined benefit system calls for change. DBP are expensive and most companies still using this structure of pension program for their employees find themselves with a deficit in the amount needed to pay those currently retired. This has caused the majority of the civilian

employers to adopt a defined contribution plan. The structure of this plan reduces the burden of cost for the employer by requiring the employee to assume a portion of the responsibility for the individual's retirement cost. In essence, it requires the individual to take responsibility for their retirement by requiring them to invest their paycheck into the future annuity rather than expecting the employer to cover the entire cost.

Defined contribution pension programs are beginning to change the American culture of entitlement. Future reform of the military pension program needs to incorporate a structure that fosters the same change in culture, from that of a sense of entitlement to a sense of personal responsibility. This will foster a necessary structural shift in the current retirement program based on defined benefit to a plan based on defined contribution. Forcing individual service members to take part in the responsibility of their own retirement necessities will not only reduce the cost of the current program, but also ensure longevity of the retirement program.

SECTION 2: THE RECENT HISTORY AND CURRENT STRUCTURE OF THE RETIREMENT PROGRAM

Since 1976, there have been several studies done to assess the need for reform of the military retirement program. These studies focused on addressing some of the following issues: cost reduction, retirement system structure, recruitment and retention impacts, as well as the relevance of the benefits provided by the current existing programs.²² Each of the studies have helped to influence the military retirement system that exists today. This section will further discuss the specific changes made to the program since 1947. Those changes have led to the three plans that all services members, active and retired, fall under today. The purpose of this section is to highlight the three plans for military members and provide an understanding of the changes to the plans that have occurred thus far.

As it stands today, there are three retirement plans that service members receive depending on when they entered into the military. They are known as Final Pay, High 3 or High 36 (Hi3/36), and CSB/REDUX. All three plans require twenty years of service (YOS) for vestment, and all have largely the same method of determining a retiree's monthly annuity. Under each plan, every YOS a member completes is worth an additional percentage of their base pay. The accumulation of percentage begins the day the service member enters the military, but a service member does not get to apply the percentage sum until vested at twenty years of service.

Service members who entered into service prior to 1980 qualify for the Final Pay plan. The members' annuity is equal to the accumulated percentage of the base pay paid in their last month of service to the military. The percentage of base pay accumulated at a rate of 2.5% for each year of service. Thus at twenty YOS the member's annuity would be 50% of his last month of service's base pay. The annuity would begin the day the service member retired and they would receive a COLA each year based on the consumer price index (CPI). If the service

member served more than twenty years, their percentage of annuity would continue to grow by 2.5% for each year served.

In September 1980, President Carter signed into law a Department of Defense Authorizations Act that changed the retirement plan from Final Pay to the Hi3 or Hi36.²³ The Hi 3/36 plan applied to all service members that entered into service between September 8, 1980 and August 1986.²⁴ This plan has the exact same framework as the Final Pay plan, except that the final annuity is determined by averaging the last three years or thirty-six months of pay to determine the base pay. The COLA also remains the same with an increase equal to CPI.

In November 1986, President Regan signed into law a Military Reform Act that changed the retirement plan from Hi 3/36 to the REDUX plan.²⁵ This reform applied to all service members that entered into the military on or after August 1, 1986.²⁶ This program kept the Hi3/36 structure to determine that base pay, but changed the accumulating annuity percentage. Instead of accumulating 2.5% per year of service, a service member would accrue 2% for each year of service during the first twenty years. The plan then changes at the twenty YOS mark to accumulate at 3.5% between twenty one to thirty YOS. This cost of living adjustment in effect catches the REDUX plan up to the previous plans at the thirty-year point of 75%. Finally, the rate reverts to an accumulation rate of 2.5% for any career greater than thirty years so that a member who serves the maximum of forty years will receive 100% of base pay for their last three years of service.²⁷ COLA also changed under this reform. Instead of a COLA equal to CPI, under REDUX it would be CPI minus 1%.

However, the REDUX plan changed in October 1999 when President Clinton signed into law a National Defense Authorization Act that modified the REDUX plan to the CSB/REDUX Plan. This legislation repealed the requirement for service members to retire under the REDUX

plan and gave them the option to opt for the new plan, CSB/REDUX, or revert to the Hi-3/36 plan. Because of having two options, service members must designate at the fifteen-year point in their career that they wish to be a part of the CSB/REDUX plan and commit to completing twenty YOS. Doing so makes the service member eligible for an up-front thirty thousand dollar bonus (\$28,600.00 after taxes), commits the service member to the two percent per YOS annuity multiplier rate and adjusts the COLA factor to CPI-1%. One caveat is that at age sixty-two, all service members who had completed less than thirty YOS will receive a onetime adjustment in their paycheck and CPI to equal that of the other two plans. Failure of a service member to select this plan in their fifteenth YOS would automatically default them to the Hi3/36 retirement plan. Failure to meet a minimum of twenty YOS will also forfeit their entitlement and require them to refund the \$30,000.00 bonus.

This section explained the three plans that all military members currently fall under for determining retirement annuity and clarifies how all three plans still follow the structure of a defined benefit plan based on a twenty-year vestment with an immediate annuity. It shows how past reform has slightly reduced cost while limiting its impact on force structure. Nevertheless, these plans and the reform that determined these plans was not enough to prevent a cost detriment to the future effectiveness of the military. While the Hi-3/36 plan is the most cost effective plan, it is still excessive and does not transfer a portion of the cost to the responsibilities of the service member. These plans were able to limit effect on forces structure and prevent opposition preventing repeal, but they did not address the long-term issue of economic impact. This section highlights the point that the current structure is out of date and is in need of reform to establish a program viable for the 21st century.

SECTION 3: THE EFFECT OF REFORM ON FORCE STRUCTURE

Change to the components of the military retirement system has a measured effect on the force structure of the armed services. So much so that in one case it caused the repeal of the 1986 reform implementing the REDUX program.²⁸ This section will discuss the impact of reform on force structure and ensure the appropriate merit is given to its effect on force structure when considering future reform. It will argue that cost-cutting reform can take place without significant effect on force structure.

Although the primary focus of this paper is on cost reduction, reform could affect force manpower and structure if the change is aggressive. Because of the difficulties associated with recruiting and retaining an all-volunteer military force, the DOD uses the current retirement program to attract new service members, as well as to retain mid-career service members. However, to what degree should the military retirement program be used as an incentive for retention? In theory, it should not be used for retention at all. It should be used only as it was intended; to support those service members after they have retired from the service.

Nevertheless, the program's affect on recruitment and more so on retention must be considered.

In most cases very few service members cited the retirement program as an incentive for entering into service and a study by CSBA indicated that young service members significantly discount the value of deferred cash benefits (retirement) compared to non-deferred cash benefits (salary).²⁹ This study indicates that incentivizing for recruitment and retention with programs such as bonuses and salary can achieve the goals of the current retirement program more effectively. In addition to retirement systems, the following tools are listed by the RAND report *Reforming the Military Retirement System* as means to affect recruitment and retention: entry

level pay, the sequencing of promotion and longevity increases thereafter, bonuses and skills specific pays, minimum standards for recruitment and retention, and “up-or-out” rules.³⁰

The 1986 legislation that enacted the REDUX program was the most significant cost reducing change affecting retirement outlay since the current military program’s inception. Although it did not change the longstanding twenty-year paradigm, it did modify the annuity reducing the cost of the twenty to twenty-nine-year retiree and incentivizing a longer stay of service. The intent of the change was to promote a longer career for those service members that normally would have retired at the twenty-year mark. Those who were opposed to the REDUX reform argued that change from the twenty-year vestment at 2.5% per YOS would adversely affect recruitment and retention.³¹ However, a study done by the Congressional Budgetary Office (CBO) in 1999 of those members expected to retire under the REDUX program showed no significant exodus of mid-career personnel.³² Appendix A Figure 2 shows a graphical representation of DOD force end-strength created by the Department of Defense Office of the Actuary (OACT). It debunks the argument of poor force retention from the REDUX reform. Additionally, all seven major studies of the military retirement program between 1947 and 1986 agreed on a reduction in the 50% base pay annuity, claiming it to be a negative impact on force structure because it only encouraged a twenty-year career.³³ The current vesting requirement encourages exodus at the twenty-year point, which benefits promotion, but limits the amount of quality officers to choose from for promotion to senior positions within the services. Unfortunately, because of the repeal of the REDUX reform in 1999, there are no statistics to show the effects of this program after the twenty-year point. Although it was designed to encourage careers greater than twenty years, the REDUX program was terminated before it

affected retiring service members and no studies were done with those members to determine if they would have stayed longer based on the change in the annuity.

According to the GAO, the DOD does not have accurate performance measures for its compensation system, which prevents it from determining the specific affect on retention.³⁴ In most cases there are too many outside economic factors to accurately predict the affects of reform on force structure past five to ten years. Thus, when DOD and lobbying groups argued against the REDUX reform citing force structure detriments, they were doing so with inaccurate data. Nevertheless, according to several sources including CSBA, citing inaccurate data worked and Congress enacted legislation to repeal the cost-reducing reform.³⁵ In all cases, the argument against reform should take into consideration the effects reform will have on force structure, but there are other tools as well. Tools such as adjusting entry-level pay and bonuses both add incentives to enter and stay in the military. Tools such as sequencing promotions, “up and out” rules and involuntary separation boards are very efficient ways of shaping the force at senior pay grades. These programs are just a few ways services can manage their respective forces separate from the delayed compensation.³⁶

In addition to these specific programs designed to deal with the force structure of the U.S. military, there are other goals that will help to shape the force of the American military. Beth Asch and her team wrote about these goals in their 1998 report, *Reforming the Military Retirement System*. The report explains that personnel need to be motivated to work hard and efficiently and that the system in which they work must sort personnel effectively.³⁷ The military has a tool for this purpose. The military’s promotion system accomplishes selective retention through evaluation reports. If senior personnel and commanding officers are evaluating their personnel effectively, then those service members that are not contributing to the future of the

military will not reach retirement status. However, the evaluation process is not perfect. There are cases that show individuals who are nearing the twenty-year service commitment with issues worthy of separation, but remain employed until retirement because of compassion or remorse towards separating a service member only a few years short of vestment.³⁸ Such actions stagnate promotion, but are compensated for by the force shaping tools mentioned above.

It is important to understand that reform of the military retirement system could have an effect on the force structure of the services. Aggressive reform of the current system would greatly achieve a fair and less costly program. However, it would adversely affect the retention requirements of the military services. As such, reform must pursue its goals of fairness and cost reduction without negatively affecting retention. The statistics provided by the OACT in its 1999 study of those affected by the REDUX reform indicates that cost saving reform is possible without an adverse affect on force structure.

SECTION 4: ARGUMENT FOR CHANGE

The scope of this argument because of all the special case service members and dependants, as well as all the variables that affect an economic based system require limiting the topic. To do so, this argument will discuss the overall cost of the DOD retirement system and related issues, but will focus on reform of the active duty non-disability retirement only. The active duty non-disability retiree makes up about 79% of the current retirement program.³⁹ This fraction is large enough for reform of the current system affecting only non-disabled retired service members to still achieve the desired cost savings.

This section will argue the points of cost reduction and fairness of entitlement of the current retirement program and how they relate to the requirements of future reform. It will argue the idea of cost as it relates to its impact on the DOD budget and how reform of the program correlates to the benefit of mission requirement. It will argue the point of fairness, which differs in expectation between that of a military service member to that of a civilian careerist. This section will show how the current program requires reform in structure that meets the expectations of both military service members and taxpayers for the direct benefit of cost reduction to ensure required military capability. This section will discuss the required shift from a defined benefit structure to a defined contribution structure to ensure its longevity in the 21st century. Finally, this section will discuss the need for gradual implementation of new reform to ensure resistance from repeal.

Previously discussed in this paper were the three general parts of the federal budget and the section discussed how by law the precedence of expenditures lay first with the interest and mandatory spending followed by discretionary spending. This requirement will likely cause a freeze and possibly a reduction in discretionary spending over the next few years in order to deal

with the national deficit. The overview of the FY2012 Defense budget released in February 2011 explains how the efficiencies and reforms of defense programs will be necessary. “[Reform of current programs] will make it possible to protect the U.S. military’s size, global reach and fighting strength despite the declining rate of growth, and eventual flattening, of the defense budget over the next five years.”⁴⁰ The current political debate over the national debt and the expected impact to discretionary spending has put pressure on the DOD to make cuts in its budget. Budgetary cuts recommended in the *FY2012 Overview* have not targeted the current retirement program, requiring the operational, training and procurement requirements of the DOD budget to absorb the effects of budget cuts. Doing so is a danger to the future of our military, national security and status as a superpower.⁴¹

The primary mission of the U.S. military is to defend America’s interests at home and abroad. Nevertheless, the DOD spends almost \$19 billion and the Federal Government almost \$50 billion to pay for the military force of the past.⁴² That amount has increased at an average rate of 4.5% per year over the past ten years. Looking back over any ten year period since 1975, the past decade is one of the smallest increases compared to a 176% increase from 1975-1985. This increase corresponded to the end of a long military conflict and aggressive growth in the American economy. Today much is similar as the near future closes the chapter on two lengthy American conflicts, both of which necessitated an increase in force strength. The current force strength will decrease in the coming years. This reduction in force will certainly produce an increase in retirees. In addition to the increase in the number of retirees, the expectation of economic growth as America comes out of its recession will cause CPI to jump. These two “cause and effect” examples will significantly increase the cost of retirement. Evidence of this is already occurring as the United States Marine Corps announced in February a drawdown in force

from an end-strength of 202 thousand to around 185 thousand starting in 2015. This will cause an increase in early retirement for service members. The Marine Corps is already reducing requirements for commissioned enlisted service members, requiring them to only serve eight of ten years before being allowed to retire at a commissioned rank, in order to entice members into early retirement.⁴³ Reforming the retirement system now will save billions of dollars over the next three decades. Congress and the DOD must implement cost saving reform in order to maintain the military force of the future while reducing the national deficit.

The greatest case for reform is the future cost of the current retirement program and the impacts of cost to the defense budget. The Government Accounting Office (GAO) found that “Pressures to reduce the federal budget deficit have focused attention of the level of payments to current military retirees.”⁴⁴ These payments totaled \$29 billion in 1995, exceeded the projected \$30 billion in 2007 and now total of \$49 billion.⁴⁵ Appendix A Figure 3 shows the expected costs of the retirement program once members began retiring under the 1986 REDUX legislation. Its repeal in 1999 drastically changed the cost curve from reduction beginning in 2006 to near vertical cost increase. Since the retirement program’s inception, there have been seven major studies by groups such as CBO, RAND and OACT to examine the retirement program and make recommendations for necessary reform. As previously stated, they all recommended less than a 50% of basic pay annuity to foster longer career length and reduce cost of the retirement program.⁴⁶ The current retirement policy is too costly in light of budgetary constraints.

According to the 2010 *Budget of the United States Government Historical Tables*, cost projection of the military retirement system will exceed \$62 billion in 2016.⁴⁷ A graph (Figure 4) of retirement costs since 1985 shows how it has continued to rise each year and the projection of

retirement outlays until 2105. This chart shows the exponential increase in cost under the current program and illustrates the undeniable requirement for reform.

It is important to clarify that the figures discussed above are the outlays of the military retirement fund and not that of the DOD budget. However, it is also important to note that there are currently more than 1.6 million members collecting retirement, of which the U.S. Treasury is paying for more than half because of the 1984 congressional legislation requiring the U.S. DOD to switch from a pay-as-you-go system to an accrual system. These facts mean that the DOD outlay to the retirement fund will need to increase as DOD begins to assume a larger portion of the total cost of the entire retirement community in addition to paying back the sixty-year loan from the Treasury to pay for the unrealized debt of the pay-as-you-go system.

According to DOD leaders, the costs of personnel, which includes retirement outlays, is affecting the amount of funding available to other portions of the defense budget, such as procurement and maintenance.⁴⁸ The DOD base budget for FY2010, not including the supplemental costs of fighting the wars in Iraq and Afghanistan, was \$530 billion.⁴⁹ A breakdown of the base budget costs shows; Operation and Maintenance is 35% with \$184 billion, Military Personnel accounts for 25% with \$134 billion, Procurement is 20% with 105 billion and Research and Development, Test and Evaluation (RDT&E) is 15% with \$80 billion. Further breaking down the military personnel portion, from which DOD retirement outlays are paid, shows outlays make up \$19 billion or 14% of personnel costs or 3.6% of the overall DOD budget. If you compare this cost (\$19 billion) to the total cost of retirement (\$49 billion) which will be the cost to the DOD budget once the U.S Treasury is no longer paying for those service members who retired prior to 1985, the increase is more than double. Reducing the amount the DOD is able to spend on operations and procurement by the projected increases in cost of the

current program as it assumes the total cost of the entire retirement community, will significantly affect the capabilities of the current and future American military force.

Currently the amount of money required of the DOD budget is \$19 billion and is increasing. It has increased over 56% since 2000.⁵⁰ The same report projects another 7% rise between 2010 and 2015. That is an average increase of 4.23% per year. Considering the life expectancy of an American, which according to the Center for Disease Control and Prevention is seventy-eight years of age,⁵¹ without reform, this increase in cost will continue until about the year 2035. Around the year 2035 the DOD outlay, if it continued per the average increase will be about \$107 billion per year. That is more than 30 % of the current DOD budget. While the current budget should increase over the next twenty-five years, the time required for a reasonable plan to eliminate the national deficit will surpass thirty years. Such a plan, regardless of how aggressive it is, will require stringent limits on discretionary spending well past 2035.

Reducing the annuity to retired service members would allow funds normally used for retirement outlays to be used in other sections of the DOD budget, payment towards the sixty-year Treasury loan or even national deficit reduction. The 1986 REDUX legislation is estimated by the DOD Office of the Actuary (OACT) to have saved \$7 billion from 1986 to 1999.⁵² These savings average over \$520 million per year. Once retirees who retired before 1985 are no longer living, the DOD outlay to the retirement fund will need to pay for an estimated 1.6 million retired service members. At that point, the burden of the current system on the defense budget would be its greatest to date or net savings from reform will yield a staggering amount.

If REDUX were reinstated today, the yearly savings would be in excess of \$700 million. The 2011 report published by the Defense Under Secretary (Comptroller), the *Overview FY2012 Defense Budget Request* facilitates the argument of benefit from savings. There are two

important points that can be made about Section 5 of the comptroller's report. In this section, it lists several recommended cuts made by Defense Secretary Gates totaling \$178 billion.⁵³ The first point is that Congress allowed DOD to retain \$100 billion of the \$178 billion cut from the budget and the DOD reinvested it into other military programs.⁵⁴ This recoupment of funds illustrates how the savings made from retirement reform would help pay for programs needed to sustain a superpower military force. The second point about Section 5 of the report is how the savings gained through retirement reform applies to offsetting cuts proposed in the FY2012 Defense budget and future budgets. Examples are listed as programs proposed for removal in the *FY2012 DOD Budget Request Overview* that will likely be cut to save money due to limited discretionary funding over the next few years. The majority of the items listed are replacement and future weapons programs and capabilities no longer funded because of other higher priority programs.⁵⁵ These cuts directly affect the future capabilities of the U.S. military. Savings from a reformed retirement program might not buy a complete fleet of replacement C-17 cargo aircraft in one year, but it would buy one aircraft per year for the next twenty years. Such purchases would preserve a C-17 fleet that will see aircraft decommissioned sooner than expected due to the higher than anticipated operational tempo during the past decade of war.

Further discussing the point made earlier about retaining savings for use in other areas, there are many individuals on both sides of the argument on where cost savings would be used. Many that believe any savings gained through reform would only fund costs outside of DOD channels. In interviews conducted with several active and retired service members and two current employees of the DOD Office of the Actuary, all believed any savings gained through reform would simply purchase other non-defense discretionary budget items or compensate for the gross inefficiencies of the military procurement program. None of the service members were

originally affected by the REDUX reform in 1986, but stated they would be willing to accept a reduction in annuity if, however, the services were to ensure their cut would be returned to the DOD to deal with legitimate budgetary shortfalls. Given the amount of argument over procurement inefficiencies and enormous cost for new technologies, their point is easy to see. However, as seen in the FY2012 defense budget overview, there is evidence showing savings from reform of DOD programs and systems would return for finance of other DOD priorities.

Current retention rates help to show that the program is more generous than it needs to be. One argument against the reform to reduce the annuity for each service member is that it will adversely affect the retention rate of mid-career service members. This affect on retention is not necessarily the case. Statistically, the majority of service members who serve more than one tour will leave between the eighth and twelfth year of service. After the twelfth year, the reduction in force strength is very low until after the twentieth YOS where departure rate is initially very high and then tapers off to a gradual reduction until the thirty-year point. Figure 5 graphically shows the force reduction rates. At the eight to twelve year point in a service member's career, the average service member is 26 to 32 years of age. It is at this point in a career that the average service member decides to either stay and continue their service or leave active duty to begin a new career. The DOD is paying more than it needs to because historical analysis of the REDUX program in 1999 shows that cost reduction of the annuity by a reasonable amount did not appreciably affect the retention rate. Although Congress repealed the 1986 REDUX legislation, it was still in effect when those originally affected by the reform were past the mid-career point of service where DOD analysis sees a high departure rate from the services.⁵⁶ (Figure 2) If reducing the cost of the annuity did not affect the retention rate of the force, then it means providing a larger annuity is excessive. This excess is at the detriment to portions of the defense

budget necessary for the U.S. military to maintain its capabilities of a superpower military. If reducing the annuity reduces the cost of the program and maintains the necessary force structure, it raises the question of how much savings can be achieved while still representing an appropriate entitlement for the sacrifices of military service.

Fairness is another reason pushing the argument of reform. Fairness is an issue brought up primarily by those in the civilian sector who argue the current program exceeds the expectations of the average American on the amount of compensation and age of entitlement for those who are now retired from the military service.⁵⁷ These critics all feel reform is needed to reduce the cost of a program that uses taxes to pay for an excessive entitlement. Then, what is considered a fair pension for the average military service member? Although the argument of fairness has many factors, which can become emotional, revealing no real definitive answer, the fact still remains that the military pension structure with a twenty year vestment and immediate annuity is one of the best pension program available to a non-disabled employee in America. No other governmental or civil pension programs have the potential to provide a retirement annuity for twice as long as the employment status. Even at a portion of the employment salary, it is still a generous program by any measure.

Both military and civilian proponents of the current retirement structure and associated costs often present the same argument. Most often, they contend that service members deserve the pension they get for the sacrifices made by serving in the military, often citing the long periods away from home and the risks assumed by those directly involved in a military conflict. Service members know the risk they are taking when they volunteer for duty. The non-deferred cash benefits such as salary and bonuses are what recruit and often help to retain those who serve today. If a pension is solely considered an entitlement for the service rendered over twenty years

in the military, what entitlement goes to the service member who does fifteen years of service? How can an individual or group argue that it is fair to provide a pension for a service member at twenty years of service, but disregard the fifteen-year service member? The twenty-year vesting requirement has a little to do with fairness, but a lot to do with retention. Nevertheless, it has not stopped individuals and groups from using the vesting point while arguing entitlement cost.

Another way to argue the issue of fairness is by trying to correlate the similarities of an occupation, similar in risk, found in the civil sector. Police officers are required to complete training that is similar to that of a new soldier. Once the training is completed, the rookie police officer has an expected level of proficiency, but a lack of experience to deal with the many situations a police officer will deal with during a career. There is a similar initial proficiency to experience ratio found in new soldiers. Advancement for a police officer is much the same as a soldier as are many of the risks. Being a police officer assigned to the rough areas of any of America's large cities is not without chance of harm or death from a gunfight. The only significant differences are the extended periods away from home, friends and family and the extreme risk a soldier endures on a more frequent basis during periods of engaged conflict.

Many service members do not endure the same risks during a career. Many military specialties such as aircrew, intelligence specialists, mechanics, administrative specialists, support personnel and naval seamen may never see the battlefield. If they volunteer for the service that they entered into, should they be entitled to a pension that is considerably more generous than what most police officers can expect to receive after thirty years of service? It is hard to justify that twenty years on a ship is more worthy of the military style pension than the thirty-year police officer. The current pension is too generous and needs reform to reduce the disparity in the entitlement for reward.

An argument by those against cost reducing reform is that a lesser program does not provide the expected entitlement to those who risked their life though service.⁵⁸ Why then not reward everyone who endures that risk? In 1996 GAO reported that only 15% of enlisted and 48% of officer service members reached retirement.⁵⁹ The CSBA reported similar figures in 2005 with 10%-15% of enlisted and 30%-40% of officers stay in until the twenty-year point. An argument of reward when it only applies to 20% of service members is not an argument at all when there is little to no compensation for the remaining 80%.

In the case of a civil enterprise, its primary responsibility is ensuring quality products or service at a competitive price to ensure longevity of the company. Its retirement program is fair if it is similar to that of other like career retirement programs and the benefits of that program are what the employer can afford to provide without influencing its primary responsibilities. For the context of this paper, a definition of a fair pension is providing the maximum entitlement that supplements the savings of an employee without affecting the primary responsibility of the company. With the case of a federal enterprise, its primary responsibility is ensuring it meets its directed intent to the fullest capability as cost effectively as possible and certainly within the budgetary limits imposed by tax revenue. The military for instance, shall execute the directives of the Nation's security concerns as directed by the President of the United States with the provided Defense budget. The primary directive of the U.S. military is to defend America and its interests at home and abroad. Paying for the military force of the past is not a primary directive. It is a secondary cost associated with its primary directive. Reform of the military retirement program needs to include this concept of balance to ensure that it provides the maximum pension to the force of the past without influencing the capabilities of the force for today and the future.

Failure to do this will cause a decline in the present and future capabilities of the U.S. Armed Forces, which in turn threatens America's national security.

Civil examples have shown unbalanced pension programs can be a detriment to the enterprise because they provide a level of entitlement without maintaining the employer's primary responsibility. Fortune 500 companies such as Bethlehem Steel, Eastern airlines, Pan Am airlines, General Motors and Chrysler have all failed to change pension programs and practices before the cost of those programs became a detriment to the existence of the company. If it were not for the intervention of the federal government, specifically the Pension Benefit Guaranty Corporation (PBGC), several more companies would no longer be active today leaving thousands of retired workers without a pension. These examples relate to the military retirement program as examples of what will happen to enterprises with very large retirement groups without the revenue to support it. Economically the structure of a defined benefit pension is feasible when the retired workforce is small and constant, and business is doing well and increasing. However, large successful enterprises will develop a large retired workforce. A large retired workforce coupled with a period of low profit for the company is what led to the demise of the mentioned companies. Here is where a comparison to the military exists. Currently the military's profits (tax revenue) are low and the retirement community is large (1.6 million). As with the civilian examples, this scenario is affecting the military's primary responsibility. Because of the lessons learned from the steel and airline industry, pensions programs began to evolve in the wake of their troubles. The structural evolution has begun to facilitate supporting the workforce of the past and maintaining the primary responsibility of the employer. Another similarity is that the military has made some changes from these lessons, but has resisted further changes due to the ability to tax by increasing national debt and the potential impacts to force

shaping. The two important changes made from the lessons learned that relate directly to reform of the military pension program are the accrual system and the defined contribution system. The accrual system and a defined contribution plan (DCP) have helped to combat against the discussed worst case scenario.

The change for the military to the accrual system was a step in the right direction. This internal structural change has saved millions of dollars since its inception in 1985, has not affected force structure and has not affected the primary responsibility of the military. The next step for the military is to follow the steps of the civil and federal based programs and change from a DBP to a DCP. By doing so, it relieves some of the burden of cost by sharing it with the service member. This also fosters greater responsibility on the part of the member to take an active role in their retirement.

In summary, the need for change has come. Much needed reform will prevent the burdens of a legacy system that has proven to adversely affect large enterprises with large retirement communities during low profit periods. If the United States is going to implement a reasonable plan to eliminate the deficit, it will need to reduce discretionary spending, which directly affects the budget of the DOD. This effect is occurring now as seen with the FY2012 budget request. As military retirement costs continue to grow, the effects will continue to grow crowding out more vital budgetary requirements thereby increasing the detriment on the primary responsibility of the U.S. Military. When this happens, and arguably, it is happening now, the effects will jeopardize American national security. Reform of the structure is required now to prevent the argued affects.

SECTION 5: PROPOSED REFORM OF THE CURRENT PROGRAM

Although this section offers a possible solution to the problems discussed throughout this paper, the following solution is a recommendation and not researched in depth. The current programs encourage mid-careerists to remain until twenty years, give little incentive to continue to thirty years, and fail to develop a 21st century program. The goal of future reform must be to reduce cost, approach the concepts of a 21st century program and must be implemented gradually to prevent repeal.

The solution offered is a combination of the FERS and REDUX programs. For the purpose of this paper, this program is named REDUX-2. Such a program is likely the quickest, easiest, and fairest solution to the primary issue of cost, while implementing 21st century change. Because its base has a proven record of accomplishment, it offers the best chance of success. This option would essentially repeal of the 1999 Military Compensation Act, reactivate the original REDUX system and add three amendments. The first amendment would be to implement the reform incrementally. Instead of having a full 10% drop in annuity between two groups, the percentage would change by 1% per year over ten years. The second amendment would be to reform the COLA adjustment from annual CPI – 1% adjustment to a onetime CPI adjustment occurring at the minimum retirement age (MRA). The third amendment would be to implement a matching contribution function similar to that of the Federal Employee Retirement System (FERS). This contribution-based system would utilize Thrift Savings Plan (TSP), which the vast majority of military service members already contribute to as a secondary means of retirement savings, and have it begin ten years after the implementation of REDUX-2.

This total reform package would result in immediate savings to the DOD budget and promote a thirty-year career. This reform would reduce costs by lowering the annuity provided

and reducing the Military Fund and Treasury outlay by only adjusting for CPI once at MRA.

This program has the potential to save additional funds because it decreases the length of time service members are paid an annuity due to incentivizing longer career lengths. In order to ensure this reform would not meet with repeal in fifteen to twenty years from its inception, as the 1986 reform did in 1999, the system would require incremental implementation. Although this measure of reform does not immediately implement a 21st century DCP structure, it does achieve cost reduction requirements while transitioning to a 21st century program, although delayed, under the same reform.

Although there was a study done to show the lack of impact that REDUX had on retention, the program's repeal took place before it was able to show effect on force structure because of incentivizing a longer career. As an additive to the REDUX-2 structural reform measures, the DOD would need to convene, on a quinquennial or as needed basis, a retirement review board. The board would involuntarily separate those members of the services that have reached twenty YOS and are no longer serving the needs of the military in order to protect against the effects of promotion stagnation.

SECTION 6: CONCLUSIONS AND RECOMMENDATIONS

The cost of the current retirement program is adversely affecting the primary mission of the U.S. military. Because of limited discretionary funds in response to the federal government's attempt to balance the federal budget and reduce the deficit, the DOD has made significant reductions to current and future programs in order to pay for current outlays. Every government program that costs more than necessary requires reform and the U.S. military retirement program is one of these programs. Cost savings from reform of the retirement program would save money and permit additional funds to pay for the primary responsibilities of the DOD.

The primary purpose of any retirement program is to provide an individual with a supplemental income to their savings from the day they exit the workforce until the day he or she passes away. The U.S. military retirement program because of its structure not only provides a supplemental income until a retired member passes away, but for many it provides supplement to a second career for in some cases twice as long as members served. This generous program has instilled a sense of entitlement and as such, the DOD uses the program as a tool for retention. For a retirement program to act primarily as an incentive for retention is wrong and reform should correct this flaw. Reform must also alter the sense of entitlement. Such reform will reduce the burden of cost the current program is placing on the military force of today and tomorrow. Failure to reform the program will have disastrous effects as it did for those civilian enterprises that have failed to reform their programs and business practices. Reform of the retirement program must adopt 21st century concepts, such as becoming a defined contribution structured program. Such reform will ensure cost reduction of the current program, now and for the future, by decreasing the federal outlay for retirement and instilling a personal responsibility in service members to invest in their own retirement.

The 1986 REDUX legislation was a step in the right direction. It reduced cost and did not appreciably affect force retention. It actually saved money and promoted a longer career. Reform of the retirement system needs to focus on saving money while providing a fair and adequate annuity for retired service members. Retirement reform continues to meet with opposition. Its delay is due in part to a lack of consensus on its effect on recruitment and retention. Disagreement on this issue must be set aside, as there is no accurate metric showing proof, in order to affect the more important issue of cost.

Reform is overdue and any reform should ensure that it provides a recalibrated but fair expectation of annuity to a retired service member. Such reform requires quick and effective cost reduction while moving towards a 21st century pension system like that of most civilian pension programs. Reform should also ensure a retirement plan that prepares for the future by teaching the value of investing in oneself. By reforming a sixty-year-old program to reflect the needs of the service members and the defense and federal budgets, the DOD can support its service members as they transition out of the military, reduce its overall costs, continue to operate, plan and prepare for the future and sustain a retirement program for many years to come. In conclusion, reform that captures all these points will ensure a 21st century program that meets not just the needs of government and service member, but the expectations of the civilian taxpayer as well.

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APPENDIX A: HISTORICAL AND PROJECTED MILITARY RETIREMENT DATA

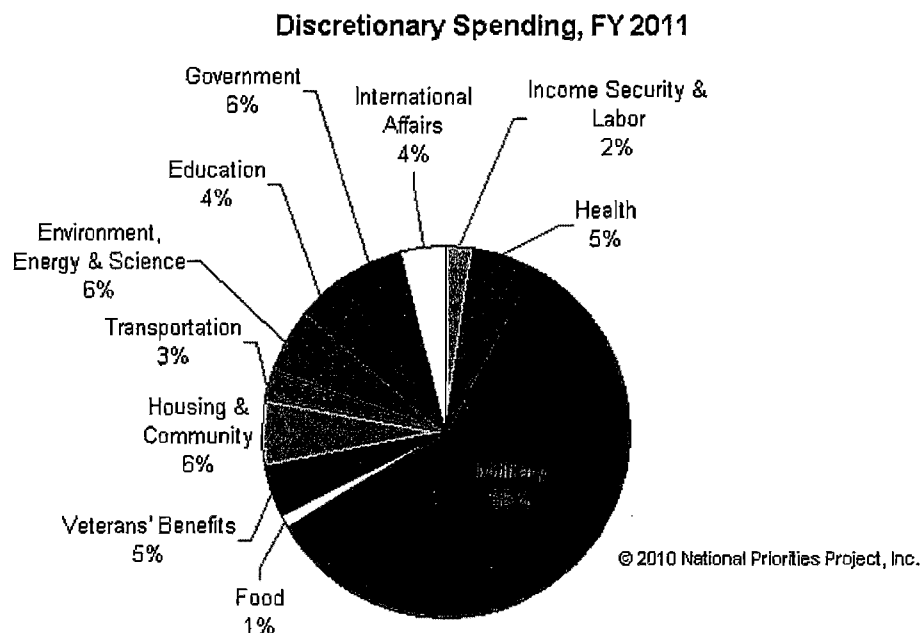


Figure 1: Federal Budget: Discretionary Spending, 2011

Source: 2010 National Priorities Project, Inc

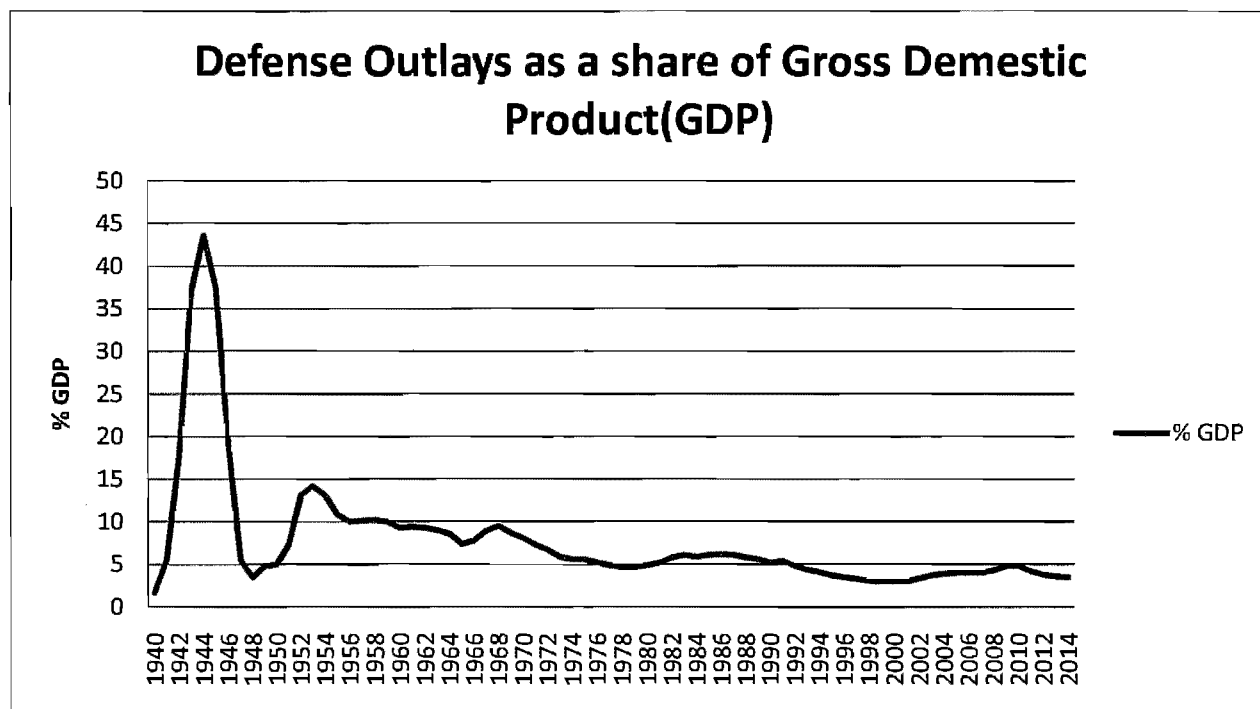


Figure 2: Defense outlays versus U.S. GDP by year

Source: Graph design by LCDR Leroy Shoesmith, Data obtained from TruthAndPolitics.ORG and www.cbo.gov.

Percentage of GDP

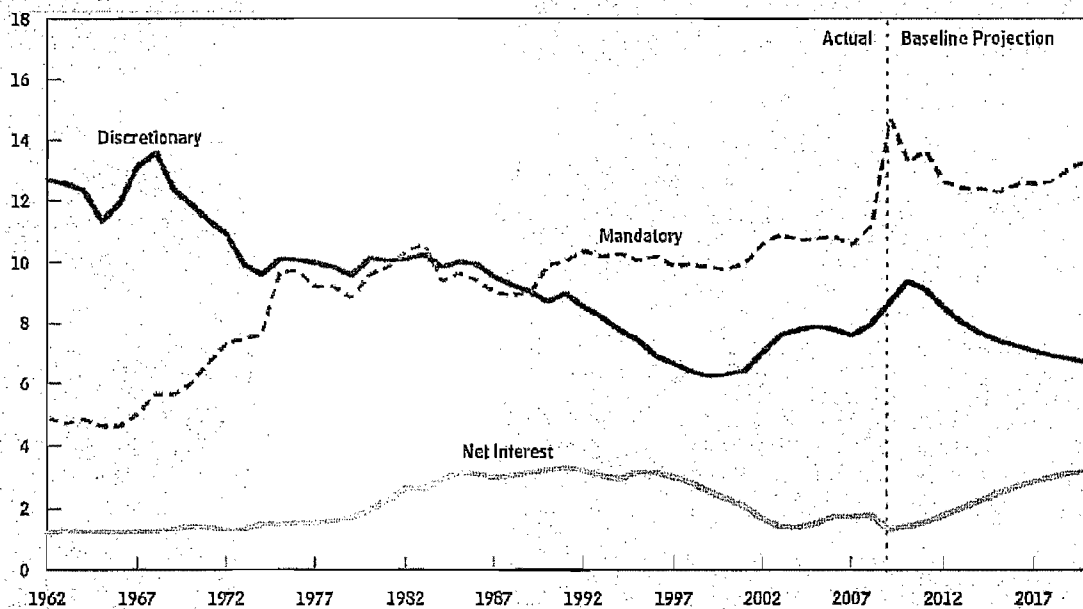


Figure 3: U.S. Federal Outlays by Category as percentage of GDP by year.

Source: <http://www.cbo.gov/ftpdocs/106xx/doc10621/DiscretionarySpending05-05.pdf> (accessed January 12 2011)

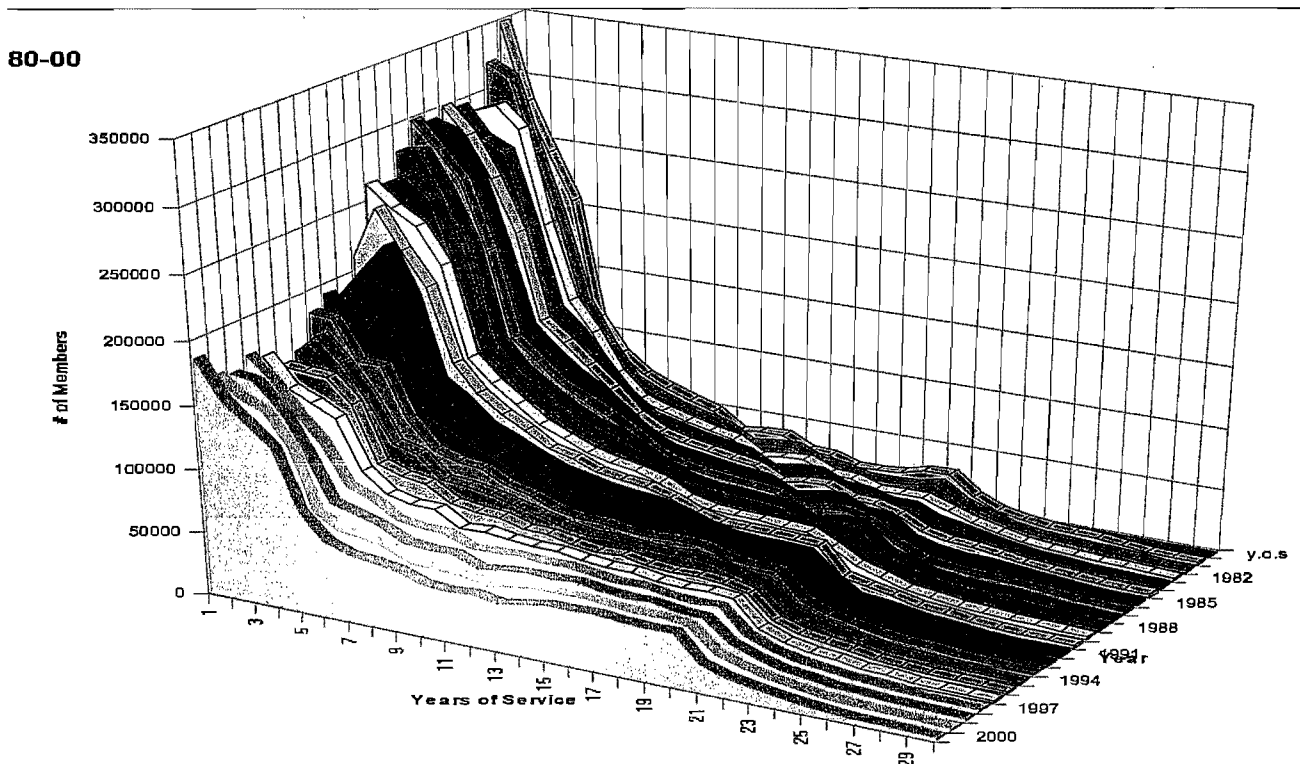


Figure 4: DOD Manpower per Year of Service by Year 1980-2000

Source: DOD Office of the Actuary

Fiscal year 1995 dollars in billions

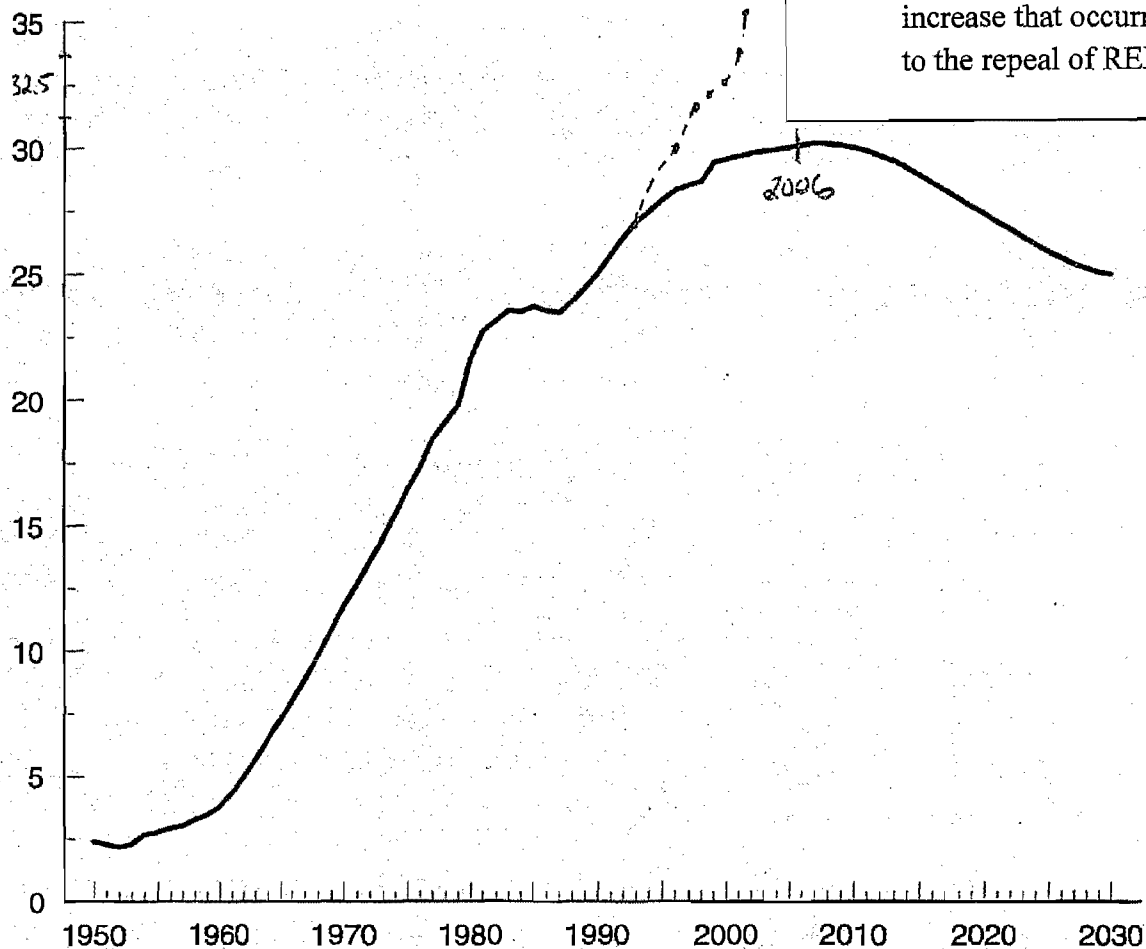


Figure 5: Military Retirement Outlays, Historical and Projected

Source: U.S. Government Accounting Office, Military Retirement Possible, Changes Merit Further Evaluation, November 1996, pg 15

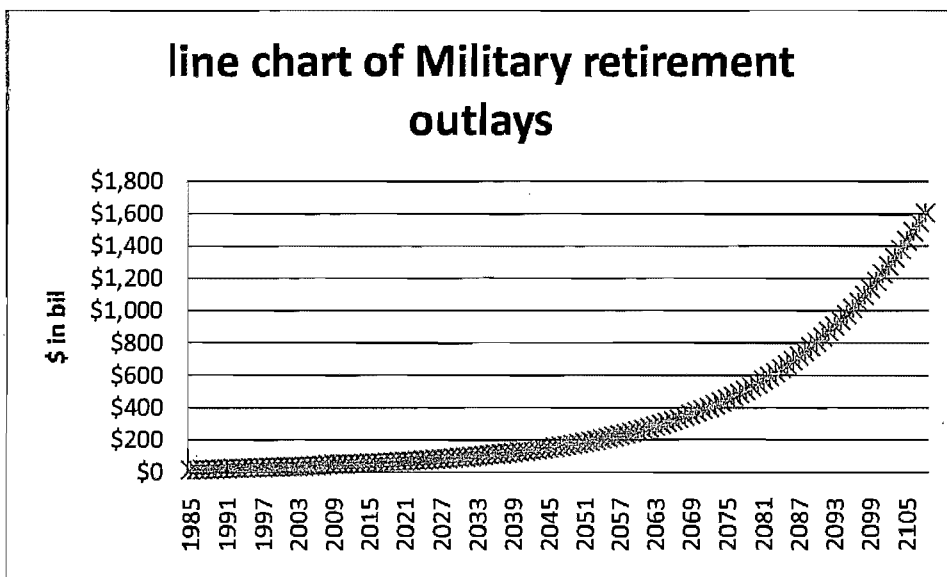


Figure 6: Military Retirement Outlays by Year

Source: DOD Office of the Actuary 2011 Military Retirement System Past and Projected Plan of Flow Assets

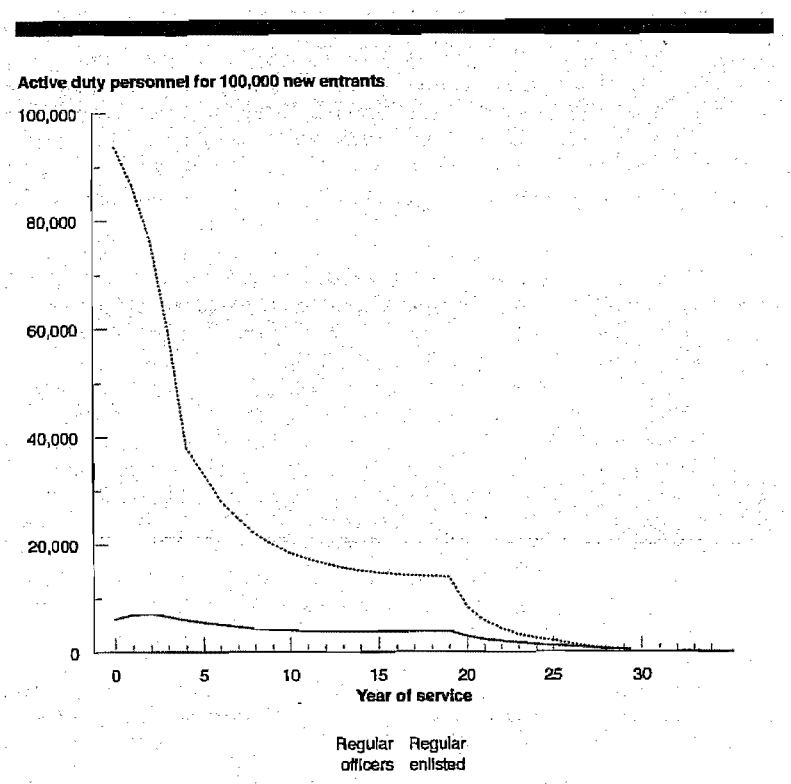


Figure 7: Retention Patterns for Active Duty Personnel

Source: U.S. Government Accounting Office, Military Retirement Possible, Changes Merit Further Evaluation, November 1996, pg 23

APPENDIX B: DEFINITIONS

from U.S. Government Accountability Office (GAO) website and BusinessDictionary.com

<http://www.gao.gov/new.items/d05734sp.pdf> (accessed January 20, 2011)

<http://www.businessdictionary.com> (accessed January 24, 2011)

Accrual Accounting – A system of accounting in which revenues are recorded when earned and expenses are recorded when goods are received or services are performed, even though the actual receipt of revenues and payment for goods or services may occur, in whole or in part, at a different time.

Outlays – The issuance of checks, disbursement of cash, or electronic transfer of funds made to liquidate a federal obligation. Outlays also occur when interest on the Treasury debt held by the public accrues and when the government issues bonds, notes, debentures, monetary credits, or other cash-equivalent instruments in order to liquidate obligations.

Budget – A detailed statement of anticipated revenues and expenditures during an accounting period. For the federal government, the term “budget” often refers to the President’s budget submission to Congress early each calendar year in accordance with the Budget and Accounting Act of 1921, as amended, and represents proposals for congressional consideration.

Federal Funds – Budgetary accounts composed of moneys collected and spent by the federal government other than those designated as trust funds. Federal fund accounts include general, special, public enterprise, and intragovernmental fund accounts.

Budget Deficit – The amount by which the government’s budget outlays exceed its budget receipts for a given period, usually a fiscal year.

Federal Debt – The amount borrowed by the government from the public or from government accounts. Four ways that federal debt may be categorized for reporting purposes are (1) gross federal debt, (2) debt held by the public, (3) debt held by government accounts, and (4) debt subject to statutory debt limit.

GDP (Gross Domestic Product) – The value of all final goods and services produced within the borders of a country such as the United States in a given period, whether produced by residents or nonresidents. The components of GDP are personal consumption expenditures, gross private domestic investment, net exports of goods and services, and government consumption expenditures and gross investment.

Fiscal Year – Any yearly accounting period, regardless of its relationship to a calendar year. The fiscal year for the federal government begins on October 1 of each year and ends on September 30 of the following year; it is designated by the calendar year in which it ends.

401K – Employer-sponsored employee benefit scheme supported by the US tax code. Under this plan, a limited amount of an employee’s before-tax salary is deposited into tax-deferred

retirement plan where it accumulate free of tax. Withdrawals by the employee before he or she reaches the age of 59½ years attract penalties except in certain cases of hardship.⁶⁰

Defined Benefit Plan - Most common type of pension plan in which an employer sets aside specific sums of money (based on each employee's tenure of service, age, and salary) for qualifying employees, in a separate tax deferred account.⁶¹

Defined Contribution Plan – Defined benefit plan to which an employee also make a fixed contribution every month until retirement. Also called defined contribution pension plan.⁶²

Force Shaping – The act of adjusting the force through different means and in different ways. The shape of a force can be increased or decreased in size or strengthened in a specific field of expertise. It can be done through promotion, involuntary separation or decreasing the number of volunteers admitted.

Force Size – The total number of service members that make up a respective force or all forces.

APPENDIX C: ABBREVIATIONS

CBO – Congressional Budgetary Office

COLA – Cost of Living Allowance

CPI – Consumer Price Index

CSB – Career Status Bonus

CSB/REDUX – REDUX repeal retirement plan, available to those who began service after 1986

CSBA – Center for Strategic and Budgetary Assessment

CSRS – Civil Service Retirement System

DACMC – Defense Advisory Commission on Military Compensation

DBP – Defined Benefit Plan

DMC – Defense Manpower Commission

DMDC—Defense Manpower Data Center

DOD – Department of Defense

DOPMA – Defense Officers Personnel Management Act

ECI – Employee Cost Index

ERISA—Employee Retirement Income Security Act

FERS – Federal Employees Retirement System

GAO— General Accounting Office

GDP – Gross Domestic Product

Hi-3/36—Average of the highest three years or thirty-six months of annual basic pay

MRA – Minimum Retirement Age

NCP – Normal Cost Percentage

OACT – Department of Defense Office of the Actuary

PBCG- Pension Benefit Guaranty Corporation

PCMC—President's Commission on Military Compensation

QRM—Quadrennial review of Military Compensation

REDUX – Military Retirement Reform Act Of 1986

RAND – Non-profit institute to improve public policy through research and analysis

TSP—Thrift Savings Plan

USRBA – Uniformed Services Retirement Benefits Act

YOS – Year(S) of Service

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